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ECONOMIC REVIEW | January 2024 US FOMC Meeting

No Change to Fed Funds Rate for Now, Timing for Rate Cuts Later than Market Predictions

- *No surprise, FFR is kept at 5.25-5.50%. The Fed's FOMC decided to keep the fed funds rate (FFR) target unchanged at 5.25-5.50% at the Jan-24 policy meeting, as expected by market consensus.*
- *Rates may be cut later but not too soon. While keeping its focus to bring down elevated inflation, the Fed signalled its openness (and expectations) for rate cuts as policy restrictiveness may be reduced as long as inflation continues to moderate and moves closer to the Fed's 2% target.*
- *Economy is solid and normalizing, but no soft landing yet. In terms of economic assessment, the Fed concluded that the US economic performance is solid, backed by continued growth in consumption expenditures. The US economy has not reached "a soft landing" because more rebalancing is needed.*
- *Expect the Fed to cut rates in the latter part of the year. Following the Fed's indication that the rate cuts may be appropriately reduced later if inflation continues to trend lower, we expect the Fed will likely cut interest rates in the latter half of 2024.*

No surprise, FFR is kept at 5.25-5.50%. The Fed's FOMC decided to keep the fed funds rate (FFR) target unchanged at 5.25-5.50% at the Jan-24 policy meeting. The decision was not a surprise as the market consensus predicted no change to the FFR. On another note, the Fed remained committed to reducing its holdings of financial securities as part of its quantitative tightening; with a total reduction of approximately USD1.34t from the Fed's balance sheet between the peak at mid-Apr-22 and end-Jan-24. In other words, policy tightening is still ongoing as inflation in the US remained above the Fed's long-term price stability target.

Rate cuts to be considered later but not too soon. While keeping its focus to bring down elevated inflation, the Fed signalled its openness (and expectations) for rate cuts as policy restrictiveness may be reduced to a more neutral level as long as inflation continues to moderate and moves closer to the Fed's 2% target. On the other hand, while the current FFR level is already restrictive to the economy, the Fed may keep the FFR at its current high level for a longer period in response to any potential upward reversal in inflation. Similarly, strong economic data also prompted the Fed to keep the current level of policy restrictiveness because easing too soon could cause inflation to trend higher once again, and the Fed highlighted concerns about subsequent policy reaction for that scenario which may require even tighter (i.e. higher) borrowing costs. At the moment, the Fed is not fully convinced inflation will continue to move lower. This explains why the Fed is not hasty to declare inflation is sustainably easing towards 2%, and therefore the Fed is expected to take time before deciding on any rate cuts, which would be later than market expectations.

The economy is solid and normalizing, but no soft landing yet. In terms of economic assessment, the Fed concluded that the US economic performance is solid, backed by continued growth in consumption expenditures. This contrasts with the Fed's previous assessment at the Dec-23 FOMC when the Fed indicated the economy had slowed from the strong growth in 3QCY23. Despite the normalizing progress, the Fed Chair stressed that the US economy and job market, including wage growth, are yet to return to normal levels. According to him, the US economy has not reached "a soft landing" because more rebalancing needs to be done and inflation needs to go lower. The FOMC did not issue any update to its economic projection after the Jan-24 policy meeting. We opine there is a high chance the US will experience a soft landing and avoid recession, given the continued resilience in consumer spending and the positive job market.

US GDP grew stronger than expected in 4QCY23. The resilience in the US economy was shown by the stronger-than-expected GDP growth in the final quarter of 2023. The US economy grew by an annualized +3.3%qoq during the quarter (3QCY23: +4.9%), higher than the +2.9%qoq growth predicted by the market consensus. The sustained growth was mainly supported by expansion in consumption expenditures on the back of a still-tight job market, positive wage growth and moderating inflation. Easing inflation and confidence in the economy also explained why recent sentiment and confidence among American consumers continued to improve in Jan-24. We foresee the improved confidence and positive job growth will continue to support the consumption outlook this year.

Inflation (and inflation expectations) continued to ease. The inflation trend in the US continued to be on moderating trend, with the Fed's preferred measure i.e. core PCE inflation easing further to +2.9%yoy in Dec-23, which was the first reading below +3%yoy in 33 months. The Fed Chairman admitted that there has been good progress with inflation in the recent 6 months, he however reiterated the Fed's focus on 12-month inflation which remained elevated and above its 2% target. Inflation expectations have also moved lower with the Conference Board consumer confidence survey, for example, highlighting that the 12-month inflation expectations dropped to +5.2%, the lowest since Mar-20. The University of Michigan consumer sentiment survey also found Americans expected lower inflation at +2.9% for the next one year, which is also the lowest in 3 years. With the Fed keeping FFR restrictive, we expect the US inflation will ease further this year as demand will be constrained by the high borrowing costs which, for instance, have already affected the US housing market.

Easing tightness in the US job market. The US job market remained tight, although the level of tightness has eased following the rebalancing of labour demand and the unemployment rate remained low at 3.7% as of Dec-23. In fact, the US labour market was more resilient in Dec-23, as shown by increases in nonfarm payrolls (Dec-23: +216K; Nov-23: +173K) and job openings (Dec-23: 9.03m; Nov-23: 8.93). We concur that there has been rebalancing in labour demand as growth in nonfarm payrolls slowed to +225K per month in 2023 (2022: +399K; 2019: +163K). Job openings also averaged lower at 9.5m in 2023 (2022: 11.2m; 2019: 7.2m). The rebalancing is not complete because of monthly increases in nonfarm payrolls and the number of job openings remained above pre-pandemic levels. While the Fed mentioned slowdown in the economy and deterioration in the job market are not the intended objectives for policy tightening, we expect further easing of labour market tightness will be a factor to watch before the Fed embarks on rate cuts.

BTFP will expire in Mar-24. The Fed also announced that its emergency bank lending programme, known as the Bank Term Funding Program (BTFP), will expire after 11th March 2024. The programme was introduced in Mar-23 to ensure American banks have sufficient funds to meet the needs of all depositors. The extra funding provides stability to the US banking system by ensuring banks have sufficient liquidity to supply money and credit to the economy. This was part of the Fed's policy response following the bank runs which led to the failure of Silicon Valley Bank and Signature Bank in the first quarter of last year. For the remaining period, the lending rate for BTFP is raised by nearly 50bps, which previously provided banks access to cheaper capital (than getting capital from the open market, especially during financial stress). We believe this indicates that confidence and stability in the US banking system have been restored, therefore banks can rely on the normal discount window or open market operations for short-term liquidity needs.

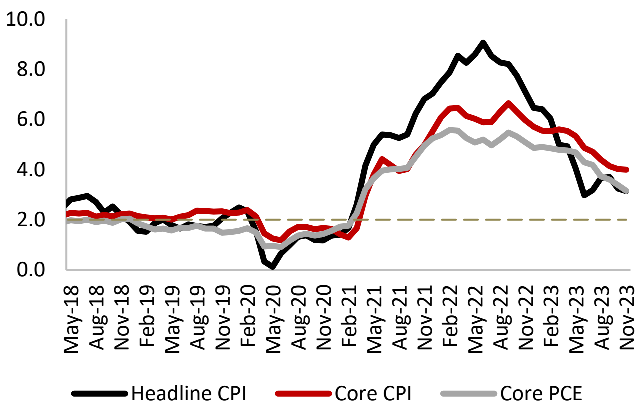
Expect the Fed to cut rates in the latter part of the year. Following the Fed's indication that the rate cuts may be appropriately reduced later if inflation continues to trend lower, we expect the Fed will likely cut interest rates in the latter half of 2024. At the moment, the Fed will be holding the high interest rates for a longer period because the Fed will need to balance between moderating inflation lower vis-à-vis the continued resilience in the US economy and the job market. However, keeping the high interest rates for too long will risk creating a sharp slowdown (or even recession) in the US economy. On the other hand, if inflation continues to move lower or economic conditions worsen significantly, the Fed has the room to bring FFR to more normal levels (and therefore reduce policy restrictiveness to the economy) or even adopt policy easing to stimulate the economy.

Table 1: Central Bank Policy Rate by Selected Economies (%)

	May-23	Jun-23	Jul-23	Aug-23	Sep-23	Oct-23	Nov-23	Dec-23	Jan-24
Malaysia	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.00
Indonesia	5.75	5.75	5.75	5.75	5.75	6.00	6.00	6.00	6.00
Philippines	6.25	6.25	6.25	6.25	6.25	6.50	6.50	6.50	6.50
Thailand	2.00	2.00	2.00	2.25	2.50	2.50	2.50	2.50	2.50
Vietnam	5.00	4.50	4.50	4.50	4.50	4.50	4.50	4.50	4.50
South Korea	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50	3.50
India	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.50
Japan	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)	(0.10)
UK	4.50	5.00	5.00	5.25	5.25	5.25	5.25	5.25	5.25
Euro area	3.75	4.00	4.25	4.25	4.50	4.50	4.50	4.50	4.50
US	5.00-5.25	5.00-5.25	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50	5.25-5.50

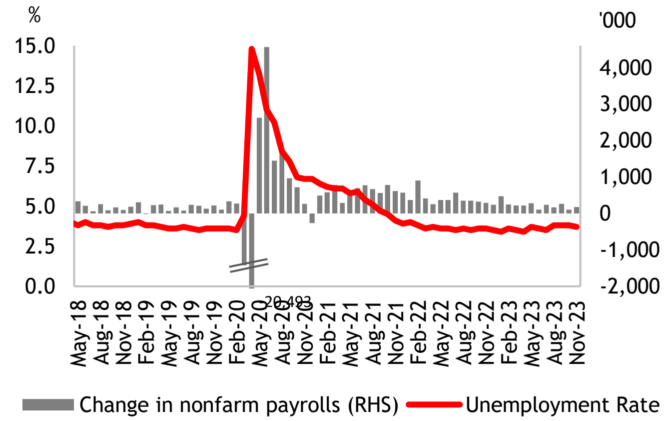
Source: Bloomberg; MIDFR

Chart 1: US CPI vs Core PCE Inflation (%)



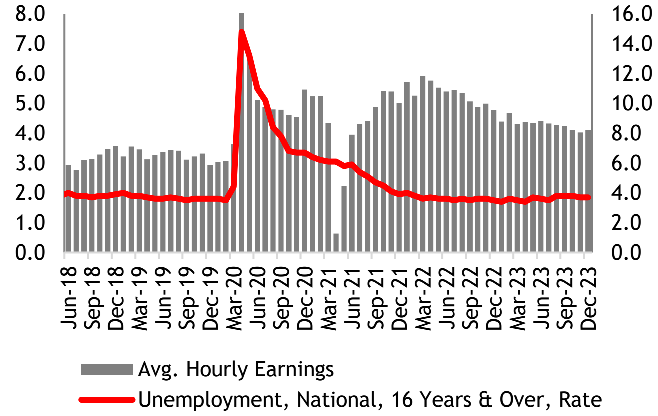
Source: Macrobond, MIDFR

Chart 2: US Unemployment Rate (%) vs Non-Farm Payroll ('000)



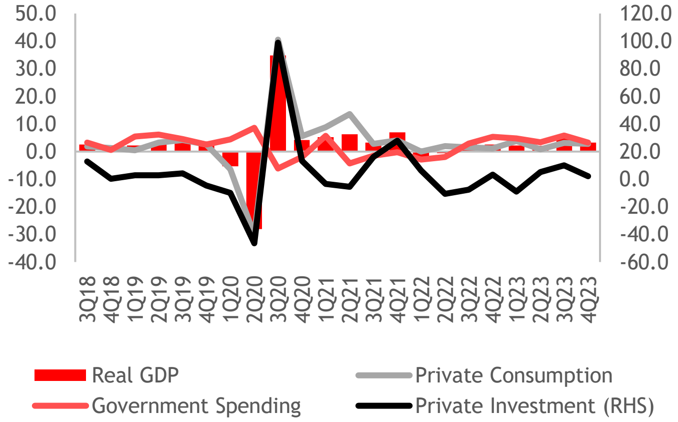
Source: Macrobond, MIDFR

Chart 3: Wage growth (YoY%) vs Unempl. Rate (%)



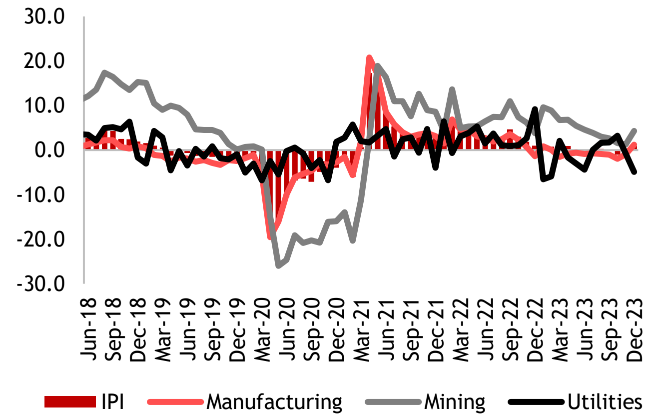
Source: Macrobond, MIDFR

Chart 4: US GDP Growth (Annualised QoQ%)



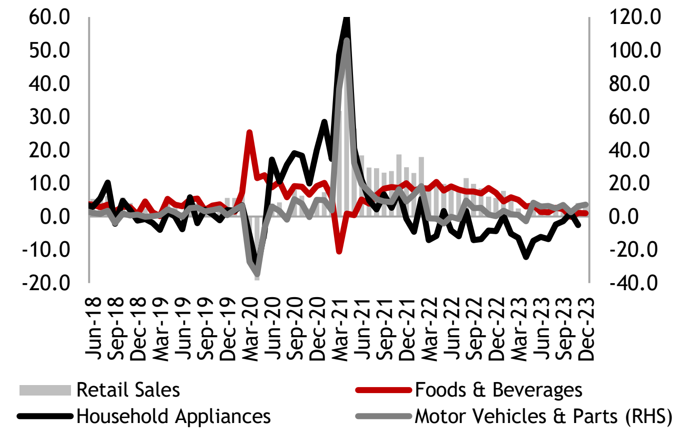
Source: Macrobond, MIDFR

Chart 5: US IPI Performances (YoY%)



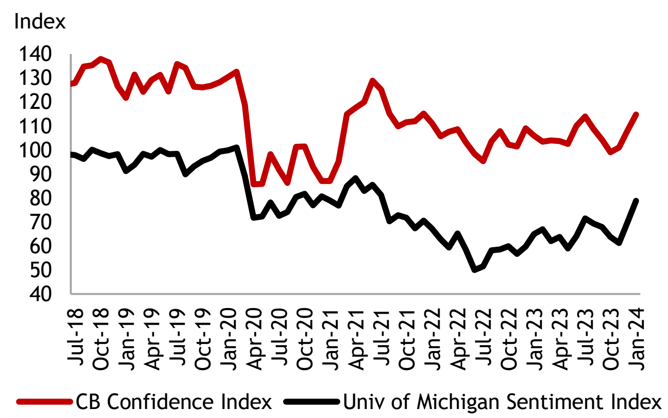
Source: Macrobond, MIDFR

Chart 6: US Retail Sales (YoY%)



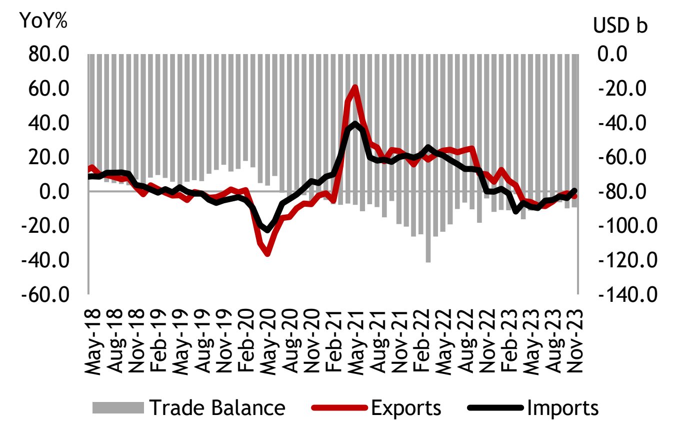
Source: Macrobond, MIDFR

Chart 7: US Consumer Sentiment & Confidence



Source: Macrobond, MIDFR

Chart 8: US Export & Import (YoY%) vs Goods Trade Balance (USD billion)



Source: Macrobond, MIDFR

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